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Summary

Household Debt and Over-indebtedness (Feature Article)

HOUSEHOLD DEBT AND OVER-INDEBTEDNESS IN AUSTRALIA

KEY FINDINGS

- In 2015-16, based on the ratio of debt to either income or assets, around three-in-ten households (29%) were classified as ‘over-indebted’.
- Debt growth has outpaced that of incomes and assets during the same period, helping to drive the proportion of households who are over-indebted up from 21% in 2003-04 to 29% in 2015-16.
- Owners with a mortgage were the most likely households to be over-indebted (47%) based on tenure type. Households with a reference person aged between 25-34 years (33%) and 35-44 years (34%) are among those most likely to be over-indebted based on age group. Of those households with a property debt, 62% of 25-34 year olds and 51% of 35-44 year olds were over-indebted.
- High income households were also more likely to be over-indebted. One quarter of the households in the top income quintile were over-indebted compared to one-in-six (16%) low income households (in the bottom 20%).
- Sydney and Melbourne had the highest number of over-indebted household at 407,000 and 419,600 households, respectively. Over-indebted Sydney households who held property debt owed $269,000 more on average than over-indebted Melbourne households who held property debt.
- Average home loans for over-indebted households were over four times the size of home loans held by other households carrying debt ($286,400 compared to $59,500), and other property loans were over 11 times the size on average ($219,800 compared to $18,500).
- Most over-indebted households (77%) lacked sufficient ‘liquid‘ assets to cover a quarter of the value of their debts. Liquid assets are assets which can be easily converted to cash and include bank accounts, shares, own businesses, and superannuation (age permitting). Lack of liquid assets may place over-indebted households at risk of defaulting on their loans if their incomes are not sufficient to meet repayments.

INTRODUCTION

Having a debt is a reality for most Australian households. However, debt can be advantageous, allowing people to smooth expenditure over a life-time or enabling purchases that are not possible using income alone. Debt can assist in the accumulation of wealth, which is an important economic resource for supporting consumption during times of reduced income.

Over recent years, rising property prices, declining interest rates and easier access to consumer credit has seen Australian households grow more comfortable with debt. However, high levels of debt, when considered against the value of current household income and assets, indicates vulnerability in the event of an economic shock, such as increases to interest rates, the loss of a job, illness or injury, a change in family circumstances or a drop in asset prices.

This article examines the debt level and profile of Australian households using two measures based on definitions used by the Organisation for Economic Co-operation and Development (OECD):

- debt-to-income ratio, where over-indebted households had debt three or more times their annual disposable income; and
- debt-to-asset ratio, where over-indebted households had debt equal to 75% or more of the value of assets.

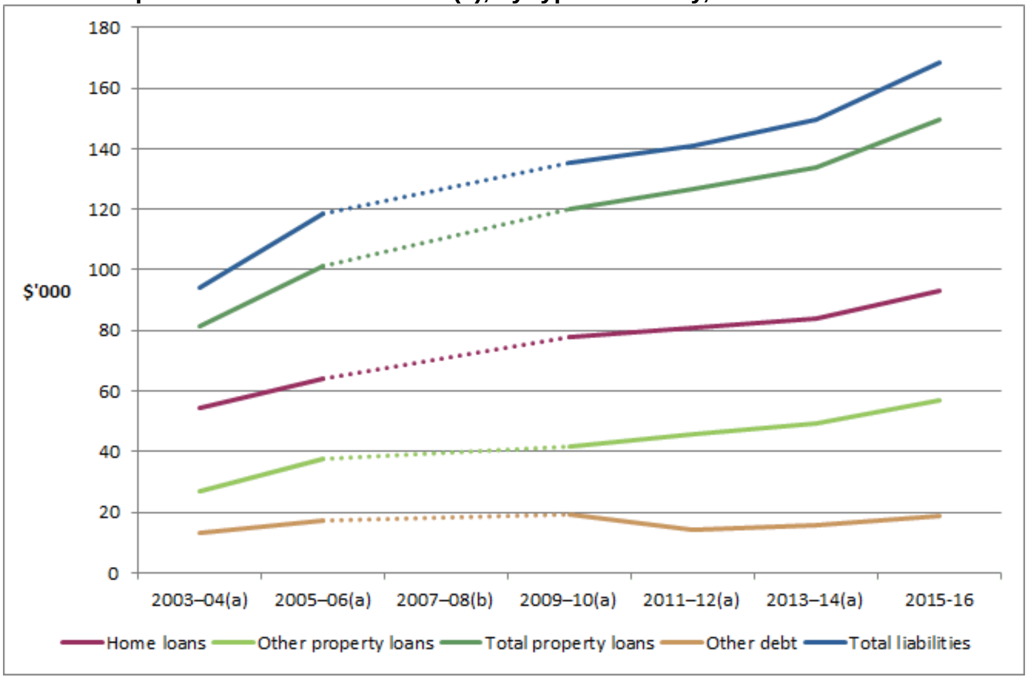
For additional data on over-indebted households, please refer to data cube 26. *Household debt and over-indebtedness*, in the ‘Downloads’ tab of this product.

HOUSEHOLD DEBT IS ON THE RISE

Over the past 12 years, the proportion of households holding debt has remained almost unchanged (73% in 2003-04,

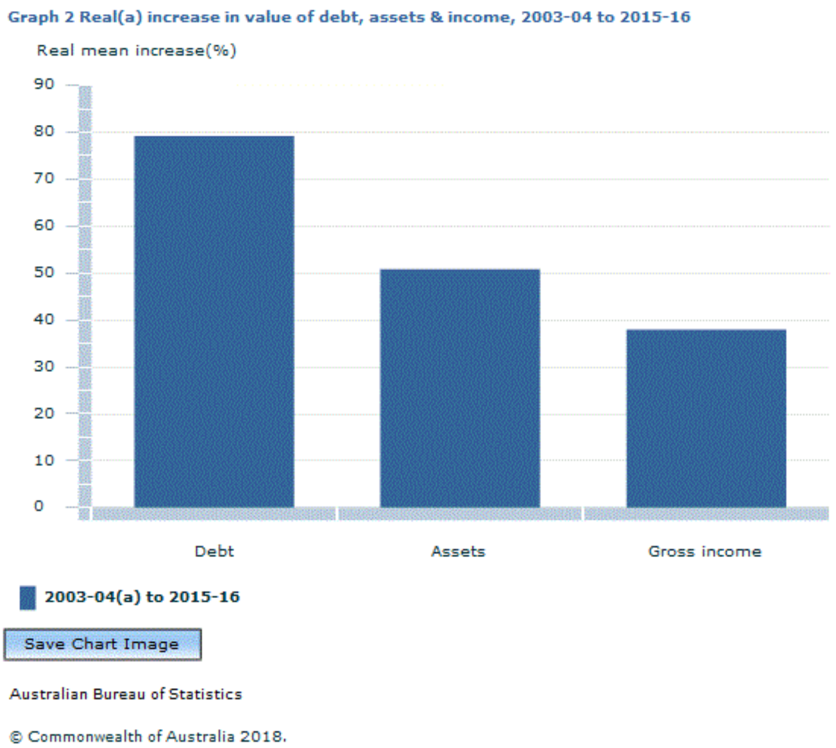
compared to 74% in 2015-16); however, average household debt (after adjusting for inflation) has almost doubled, increasing from $94,100 in 2003-04 to $168,600 in 2015-16. This increase was mostly driven by property debt, which has increased steadily over the period, from $78,400 in 2003-04 to $149,600 in 2015-16.

Graph 1 Mean household debt (a), by type of liability, 2003-04 to 2015-16



Footnote(s): (a) In 2015–16 dollars, adjusted using the Consumer Price Index
(b) Comprehensive wealth data was not collected in 2007–08
Source(s): ABS Survey of Income and Housing

This growth in household debt was larger than the growth in income and assets over the same period. The mean household debt has increased by 79% in real terms since 2003-04. By comparison, the mean asset value increased by 51% and gross income by 38%.



Footnote(s): (a) Data from 2003-04 are in 2015-16 dollars, adjusted using the Consumer Price Index

Source(s): ABS Survey of Income and Housing

In 2015-16, around three quarters (74%) of households held debt, and the average household debt of all households

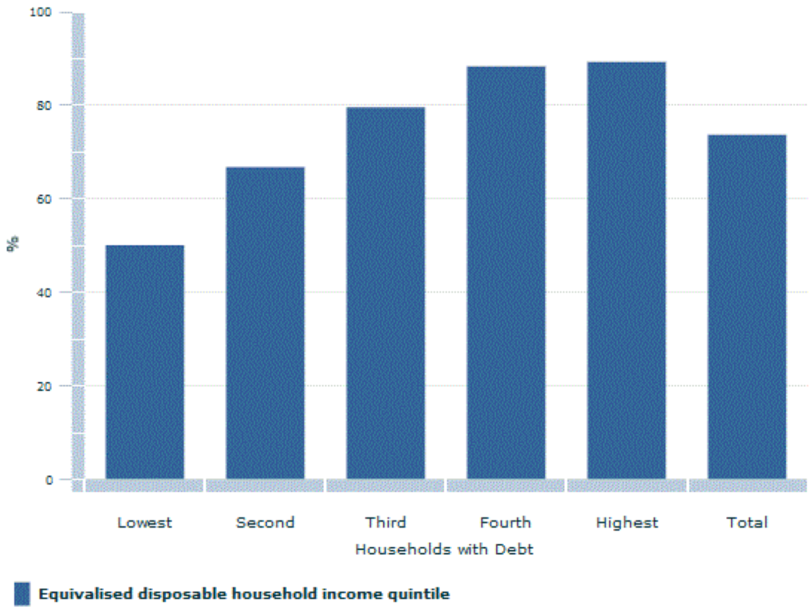
was $168,600. The most common form of debt was credit card debt, held by 55% of households, followed by home loans (34%) and student loans (17%).

The largest contributor to debt was home loans, which made up 56% of total household debt. This was followed by other property loans (33%) and investment loans (5%).

MOST DEBT WAS HELD BY TOP INCOME EARNERS

Not all households can access debt, nor do they acquire the same type of debts. In particular, households with low incomes, fewer assets, or in later life-stages are often viewed by lenders as a higher risk, and therefore have difficulty securing loans. Graph 3 shows that in 2015-16, households with higher incomes were more likely to hold debt, with 89% of households in the top equivalised disposable household income quintile holding debt, compared to half of those in the lowest quintile. The amount of debt held by households also varied across the income distribution, with households in the highest income quintile holding debt that was over seven times larger than the debt held by households in lowest quintile ($386,300 compared to $52,600).

Graph 3 Household Debt, by Equivalised household disposable income (EDHI) quintile, 2015-16



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Households with Debt

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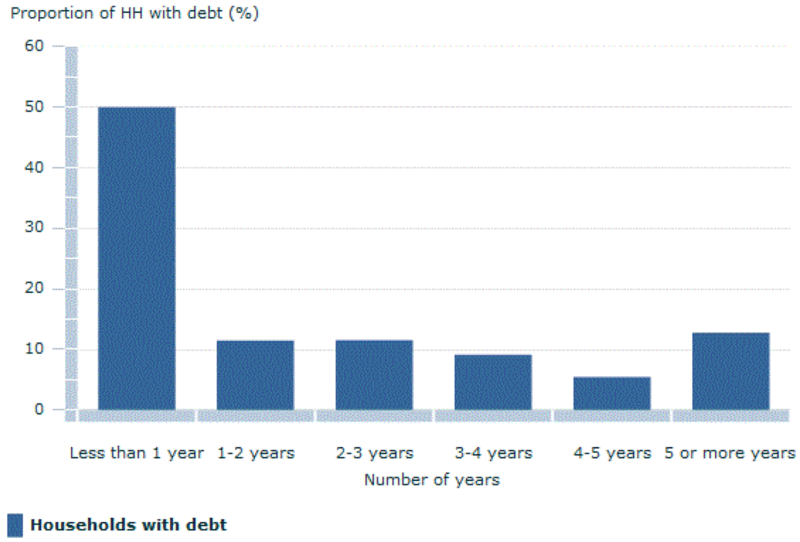
Source(s): Survey of Income and Housing

MEASURING OVER-INDEBTEDNESS

Debt ratios are a common measure to assess a household's ability to service their debt, and determine which households are 'over-indebted'. This article uses the OECD debt-to-income and debt-to-asset ratios as measures of over-indebtedness.

In 2015-16, half of all households with debt had loans equalling less than one year of annual disposable income. Around one-in-four households with debt (27%) fit the definition of over-indebtedness as they had liabilities equal to 3 or more years of disposable income.

Graph 4 Households with debt, size of debt in terms of annual household disposable income, 2015-16



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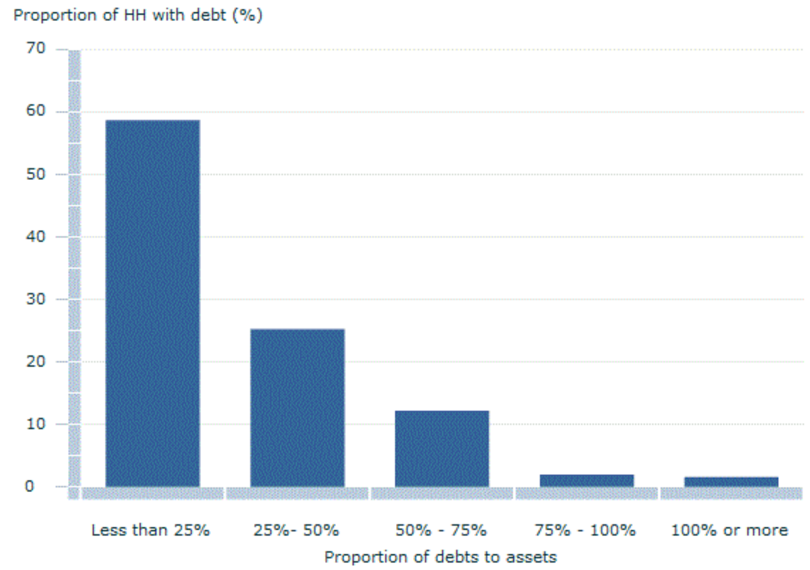
Source(s): ABS Survey of Income and Hosuing

In terms of asset values, most households had debt that was less than a quarter of the value of their assets (59%). A small group of households (4%) fit the debt-to-asset ratio definition of over-indebtedness with debt 75% or greater than the value their assets. Almost half of these households were considered over-indebted on both ratios.

Graph 5 Households with debt, size of debt in terms of assets, 2015-16



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Source(s): ABS Survey of Income and Housing

In 2015-16, around three in ten households (29%, or 1.9 million households) were over-indebted based on either the OECD debt-to-income ratio or the debt-to-asset ratio, up from 21% in 2003-04. A small proportion of households (1.5%) were considered over-indebted on both ratios. When discussing these households, the term 'over-indebted households' will refer to households that are over-indebted based on either the debt-to-income or debt-to-asset ratio.

Table 1: OVER-INDEBTEDNESS BY RATIO, Households in debt, 2015-16

	Debt-to-income ratio		
	Over-indebted (Debt 3 or more times annual disposable income)	**Not over indebted** (Debt less than 3 times annual disposable income)	**Total households in debt**
Debt-to-asset ratio			
Over-indebted (Debt equal to 75% or more of assets)	1.5% (95,840 households)	2.2% (147,521 households)	3.7% (243,361 households)
Not over-indebted (Debt less than 75% of assets)	25.7% (1,693,466 households)	70.6% (4,652,433 households)	96.3% (6,345,900 households)
Total households in debt	27.2% (1,789,306 households)	72.8% (4,799,954 households)	100% (6,593,564 households)

Source(s): ABS Survey of Income and Housing

CHARACTERISTICS OF INDEBTED AND OVER-INDEBTED HOUSEHOLDS

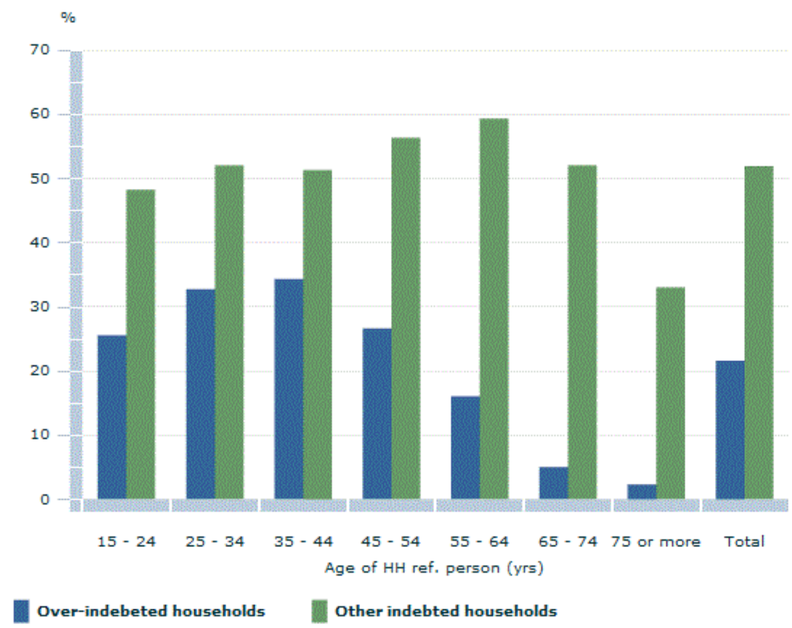
Among the groups most likely to be over-indebted in 2015-16 were owners with a mortgage (47%), and households with a reference person aged 25-34 (33%) and 35-44 years (34%).

Households with a reference person aged 65 or more (5%), households that owned their home out-right (4%) or rented (9%), and households whose main source of income was from government pensions and allowances (7%) were least likely to be over-indebted.

A quarter of the households in the top equivalised disposable household income quintile were over-indebted compared to one-in-six (16%) low income households (in the bottom 20%).

The wealthiest 20% of households were more likely to hold debt ($292,000 on average, six times larger than the $46,100 held by the bottom 20% of households). However, households in the second and third quintiles of wealth had the highest rates of over-indebtedness of all quintile groups.

Graph 6 Over-indebted & other indebted households, Household characteristics, 2015-16



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Age of household reference person

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Footnote(s): (a) Includes households with nil or negative income and other income;;

Source(s): ABS Survey of Income and Housing

At a national level, households in capital city regions were as likely to be over-indebted than those in the rest of the state (24% and 23% respectively), however, this varied across the states and territories.

The capital city with the greatest proportion of over-indebted households was Darwin (32%), followed by Perth (27%). However, these cities had smaller populations compared to Sydney and Melbourne, who had a greater number of over-indebted households (407,000 and 419,600 respectively) than all other capital cities. Together, Sydney and Melbourne made up 43% of over-indebted households, while only accounting for 38% of total households.

Graph 7, Over-indebted & other indebted households, State & Territory, 2015-16

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Greater Capital City Area

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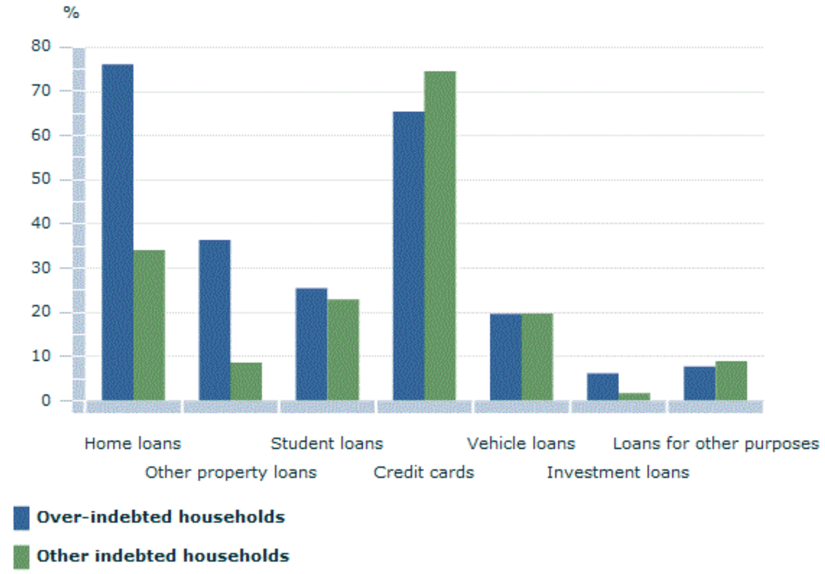
Footnote(s): (a) Capital city estimates for the ACT relate to total ACT;(b) Includes NT households. NT estimates are not shown separately since estimates for the NT other than Darwin are not considered reliable. Does not include ACT. See Explanatory Notes for more information

Source(s): Greater Capital City Area; Rest of State

Debt profile

Over-indebted households were over twice as likely as other indebted households to have a home loan (76% of over-indebted households, compared to 34% of other indebted), and approximately four times more likely to hold other property loans (36% compared to 9%). Conversely, other indebted households were more likely than over-indebted households to have credit card debt (74% compared to 65%).

Graph 8, Households with debt, Debt types, 2015-16



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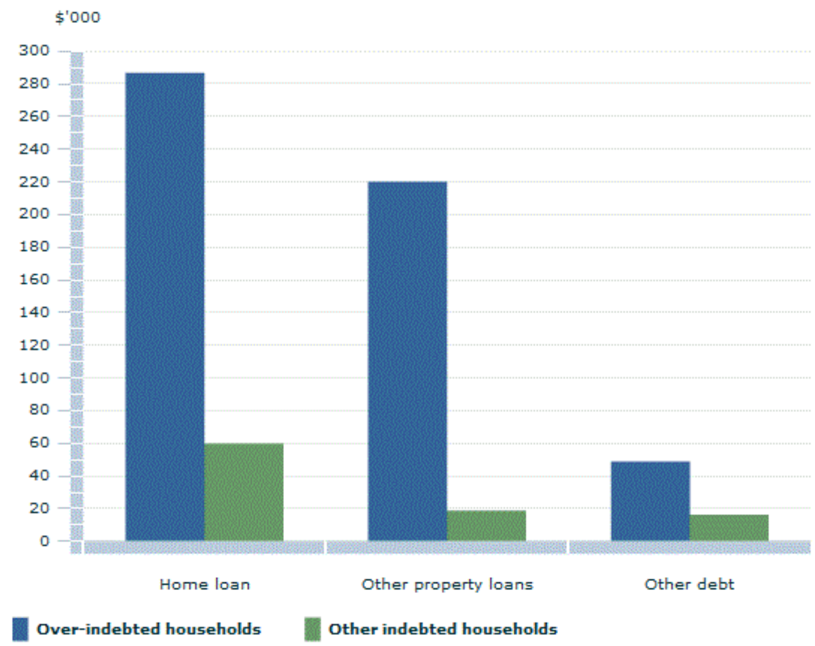
Source(s): ABS Survey of Income and Housing

Over-indebted households held home loans that were over four times the average size of those owned by other indebted households ($286,400 compared to $59,500), and other property loans that were over 11 times the size ($219,800 compared to $18,500). Over-indebted households were also more than three times as likely to hold investment loans, and the average value of these loans was around 12 times larger for over-indebted households.

Graph 9, Households with debt, Average value of debts, 2015-16



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Total loans

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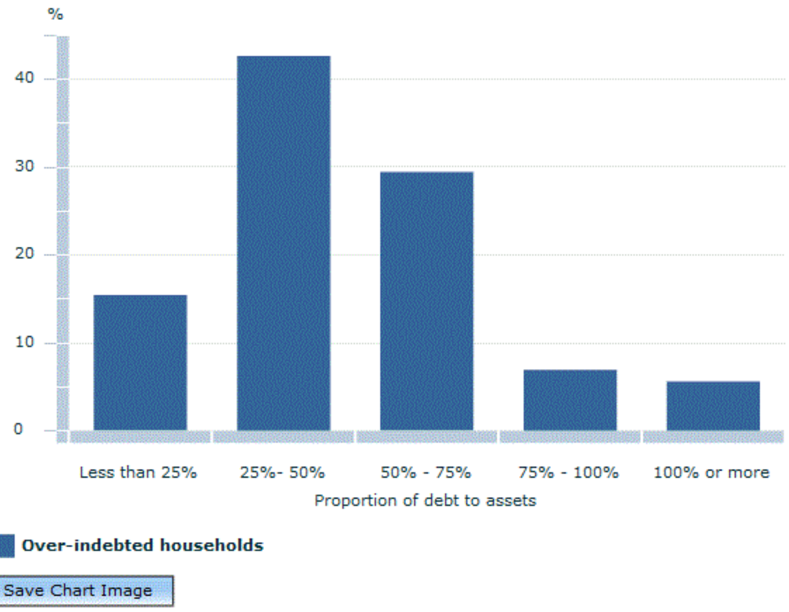
Source(s): ABS Survey of Income and Housing

Ability to service debt

As most over-indebted households are identified through the debt-to-income ratio, some had assets valued higher than their debts. The following graph shows that over half (58%) of over-indebted households had debt valued at less than half of their assets.

Graph 10, Over-indebted households, Debt as a proportion of assets, 2015-16



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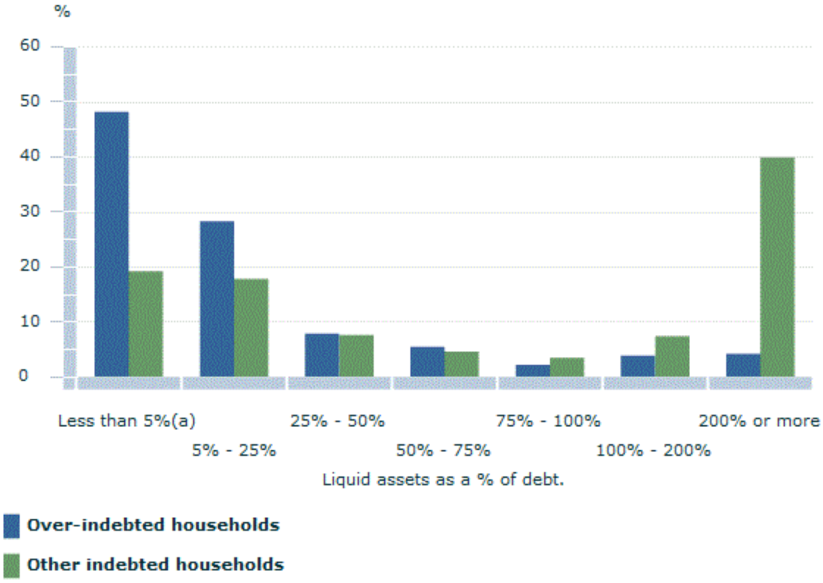
Source(s): ABS Survey of Income and Housing

The majority of these assets, however, were property assets, which can be difficult to sell off, if required. Liquid assets, such as bank accounts, shares, own businesses, and superannuation (where eligible, see Technical Note) can be more easily converted to cash to service debt, if required.

Most over-indebted households (77%) did not have enough liquid assets to cover a quarter of the value of their debts, and nearly half (48%) had liquid assets valued at less than 5% of their debts. Conversely, over half of other indebted households (55%) had liquid assets equal to or greater than the value of their debt.

Graph 11, Liquid assets as a proportion of debt, 2015-16



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Footnote(s): (a) Includes households with nil or negative liquid assets

Source(s): ABS Survey of Income and Housing

HOUSEHOLDS WITH PROPERTY DEBT

As most debt and over-indebtedness relate to property ownership, selected information on households with a property debt is presented below. In addition, the table provides an indication of the additional payment needed per week if there were a one percentage point annual increase to interest rates (based on the total principal outstanding on property loans, see technical note). Complete information for these groups are available in data cube 26. *Household debt and over-indebtedness*, in the 'Downloads' tab of this product.

Table 2: OVER-INDEBTED HOUSEHOLDS WITH PROPERTY DEBT, Selected characteristics, 2015-16

	Over-indebted as a proportion of indebted(a) %	**AVERAGE TOTAL MORTGAGE REPAYMENTS**		**AVERAGE PRINCIPAL OUTSTANDING**		**Illustrative additional repayment (1 pp p.a. increase)**(b) ($ per week)
		Interest component ($ per week)	**Principal component** ($ per week)	**Owner-occupied dwelling** ($'000)	**Other property** ($'000)	
Age of household reference person						
25 to 34 years	62.0	317	168	323.2	117.4	*84*
35 to 44 years	51.3	371	213	375.2	169.4	*106*
Equivalised disposable household income quintile						
Lowest	69.0	224	128	220.4	117.0	*64*
Highest	37.2	485	269	448.9	463.2	*168*
Net worth quintile						
Lowest	83.3	221	202	282.0	*97.0	*70*
Highest	47.3	399	244	353.3	572.6	*170*
Capital City						
Sydney	51.4	417	259	389.9	368.7	*139*
Melbourne	50.9	324	168	326.1	173.6	*96*
Perth	54.6	376	167	378.8	196.0	*110*
Darwin	69.0	365	188	325.2	220.9	*108*

Source(s): ABS Household Expenditure Survey
* estimate has a relative standard error of 25% to 50% and should be used with caution
(a) Proportion among all households with property debt.
(b) Estimated weekly increase in total mortgage repayments necessary, based on total property debt, if interest rates increased by one percentage point per annum. Does not account for differences in loan conditions, such as whether loans had a fixed or variable rate. See technical note for more information.

Younger households with property debt tended to experience higher rates of over-indebtedness. Three out of five households with property debt and a reference person aged 25 to 34 years (62%) were over-indebted, owing $439,200 on average in property debts. Similarly, half of the households with property debt and a reference person aged between 35 and 44 years were over-indebted (51%), and these households owed $546,800 on average in total property loans. Nearly two-thirds of the repayments made by both these younger age groups went towards the interest component of the loan. If interest rates for property loans increased by one percentage point for these households, the amount of additional interest would equate to approximately half of their current weekly principal repayments.

Over-indebted high income and high wealth households (with property debt) owed the most, with around $912,700 and $924,400, respectively, on average in property debt. Should interest rates increase by one percentage point, approximately $170 per week would be needed by these households to cover additional repayments, which would likely impact high income and high wealth households differently. High income households paid a total of $754 per week towards their property debt, almost $110 more than high wealth households, and also paid around $86 per week more in interest.

Over three quarters (83%) of low wealth households and over two-thirds of low income households (69%) who had property debt were over-indebted, owing an average of $388,300 and $332,200 respectively. A one percentage point increase in interest rates would imply a $70 increase in required repayments for low wealth property owning households, around $6 more than the additional repayments needed by low income property owning households under the same increase.

Among the state and territory capitals, Darwin had the highest rate of households with property debt who were over-indebted (69%), with these households owing $580,600 in total property debt. This was followed by Perth, where over half of property owning households were over-indebted (55%). These households held an average of $574,200 in total property debt.

Half of Sydney households with property debt were over-indebted (51%), with these households owing $765,400 in total property debt. Around half of Melbourne households with property debt were also over-indebted (51%); however their average property debt was considerably less, at $496,400. An additional one percentage point interest rate rise might therefore cost over-indebted Sydney households around $43 more per week than Melbourne households.

TECHNICAL NOTE

Equivalisation

Equivalisation is a method of standardising the income of households to take account of household size and composition differences. This enables more meaningful comparisons to be undertaken across different households.

An equivalising factor is used which assigns a value of 1 to the household head, 0.5 to each additional person 15 years or older and 0.3 to each child under 15 years. For example, a couple with one child under 15 years would have an equivalising factor of 1.8 and therefore need an income of $1,800 to have the same equivalised income as a lone person household with an income of $1,000.

Liquid assets

Liquid assets are those that can be readily accessed to support consumption needs. This includes all financial assets such as bank accounts, shares, and the value of people’s own businesses. Superannuation is included in the liquid assets of individuals 65 years and over, or aged 55-64 and not in the labour force, but is excluded from the liquid assets for people under 65 years, as they cannot usually access this asset until retirement age.

Illustrative additional repayment (1 pp p.a. increase)

The illustrative additional payment is an estimated weekly increase in total mortgage repayments necessary, if interest rates increased by one percentage point per annum. This additional payment is calculated based on the principal outstanding on total property debt, and is meant to give an indication of the potential increase to weekly housing costs. The modelling of this item does not account for differences in loan conditions, such as whether loans had a fixed or variable rate, size of offset accounts, or whether households are ahead in their mortgage payments.

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